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No. 99-387

Supreme Court, U.S.
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IN THE
Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee
for the Estate of William J. Stoecker,
Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF OF PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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BRIEF OF PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF THE AMICUS CURIAE

The Pension Benefit Guaranty Corporation ("PBGC")[1] is a wholly owned United States government corporation

[1] PBGC is an "agency of the United States allowed by law to appear before this Court" within the meaning of Rule 37.4 of this Court's rules. Congress empowered PBGC "to sue and be sued, complain and defend, in its corporate name and through its own

created under Title IV of ERISA.[2] 29 U.S.C. § 1302. Modeled after the Federal Deposit Insurance Corporation, PBGC guarantees the payment of nonforfeitable benefits in defined benefit pension plans sponsored by private businesses. *See generally LTV*, 496 U.S. 633; *Nachman*, 446 U.S. 359. When a pension plan terminates with insufficient assets to pay promised benefits, PBGC takes over the assets and liabilities of the pension plan and pays guaranteed benefits to participants and their beneficiaries. 29 U.S.C. §§ 1322, 1342(c), (d), 1361. The statute then gives the agency a precisely defined, one-time claim against the employer (and related companies) for the shortfall. 29 U.S.C. § 1362(a), (b).

This case is important to PBGC because bankruptcy is the primary arena in which PBGC asserts its claims. During the period from 1975-98, most of the liabilities covered by PBGC's insurance fund arose from the bankruptcies of pension plan sponsors. Of the ten cases that have presented the largest claims against PBGC's insurance system in its 25-year history—resulting in a total exposure of $3.1 billion—eight involved bankruptcies.[3] In

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counsel, in any court, State or Federal." 29 U.S.C. § 1302(b)(1). PBGC has appeared before this Court through its own counsel both as a party, *see, e.g., PBGC v. LTV Corp.*, 496 U.S. 633 (1990); *Nachman Corp. v. PBGC*, 446 U.S. 359 (1980), and as an *amicus curiae, see, e.g., Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 621 (1993); *Commissioner v. Keystone Consol. Indus.*, 508 U.S. 152, 162 n.3 (1993); *Mead Corp. v. Tilley*, 490 U.S. 714, 722, 726 (1989).

[2] The Employee Retirement Income Security Act of 1974, *as amended* ("ERISA"), 29 U.S.C. §§ 1301-1461 (1994 & Supp. III 1997).

[3] *See* PBGC, *Pension Insurance Data Book 1998* 11, 13-14, tab. S-12 (1999). A recent congressional report on PBGC's financial status warned:

> [A] few pension plans with extremely large unfunded liabilities have dominated PBGC's past claims . . . . PBGC's losses with respect to future terminations will depend on how well companies fund their plans, and on the PBGC's position in bankruptcy proceedings. Finally, pending litigation could have a material impact on the financial condition of the PBGC.

Staff of House Comm. on Ways and Means, 105th Cong., 2d Sess., 1998 Green Book: Background Materials and Data on Programs Within the Jurisdiction of the Comm. on Ways and Means 915 (Comm. Print 1998).

1998 alone, a year in which the economy was generally strong, PBGC was a claimant in several hundred bankruptcy cases nationwide, with claims totaling approximately $2.7 billion.[4]

This case calls upon the Court to decide whether the entitlements conferred upon a party by substantive nonbankruptcy law—here, the burden of proof under the Illinois Use Tax Act—may be cast aside by a bankruptcy court on the basis of equitable considerations. PBGC has an acute interest in this issue because in recent years, courts have disregarded ERISA in determining PBGC's bankruptcy claims, under the rubric of doing "equity" among creditors.

In 1987, Congress defined the amount of an employer's termination liability to PBGC as the "total amount of the unfunded benefit liabilities (as of the termination date)." 29 U.S.C. § 1362(b)(1)(A). Congress further directed that the "value" of the pension plan's benefit liabilities be determined "on the basis of assumptions prescribed by [PBGC]." 29 U.S.C. § 1301(a)(18). Years earlier,

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[4] PBGC's recurring appearance as a large claimant in Chapter 11 bankruptcies prompted Congress in 1994 to amend the definition of "person" in the Bankruptcy Code to include a governmental entity that "is a guarantor of a pension benefit payable by or on behalf of the debtor," 11 U.S.C. § 101(41)(B), so that PBGC could sit on creditors' committees, 11 U.S.C. § 1102(b)(1).

PBGC had promulgated a regulation prescribing those assumptions.[5] Thus, Congress mandated use of PBGC's regulatory assumptions against the backdrop of a specific, preexisting regulatory approach for calculating the amount of PBGC's claim.

Nevertheless, in recent years, courts have taken the position that this regulation, while valid outside of bankruptcy, should not be used to determine the amount of the claims asserted by PBGC in bankruptcy. For example, the Tenth Circuit recently held that "even though that methodology [in PBGC's regulation] was adopted in the exercise of PBGC's administrative authority, we have no doubt of its inapplicability in the world of bankruptcy." *PBGC v. CF&I Fabricators of Utah, Inc.* (*In re CF&I Fabricators of Utah, Inc.*), 150 F.3d 1293, 1301 (10th Cir. 1998), *cert. denied*, 119 S. Ct. 2020 (1999). The court instead relied on its own notion of equality among creditors to cut PBGC's claim in half. *Id.* Other lower courts have similarly spurned ERISA and the implementing regulations in favor of an "equitable" recalculation of PBGC's claims.[6]

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[5] PBGC's regulation for valuing pension plan liabilities was adopted on an interim basis in 1976 and finalized in 1981. The regulation was issued in full compliance with the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. § 553. *See* Valuation of Plan Benefits, 40 Fed. Reg. 57,982 (1975) (proposed rule); 41 Fed. Reg. 48,484 (1976) (interim rule); 46 Fed. Reg. 9492 (1981) (final rule), *codified as amended at* 29 C.F.R. § 4044.41-75 (1999), *amended by* 65 Fed. Reg. 14,752 (2000). The regulation produces a value of benefit liabilities in line with prices of insurance company annuity contracts. *See* 50 Fed. Reg. 5128 (1993) (proposed rule); 50 Fed. Reg. 50,812 (1993) (final rule).

[6] *See PBGC v. Belfance* (*In re CSC Indus.*), No. 95-4103, 1997 Bankr. LEXIS 2155 (Bankr. N.D. Ohio Dec. 3, 1997), *aff'd*, No. 4:99CV00041 (N.D. Ohio Aug. 10, 1999), *appeal docketed*, No. 99-4243 (6th Cir. Oct. 7, 1999); *LTV Corp. v. PBGC (In re Chateaugay Corp.)*, 130 B.R. 690, 695-96 (S.D.N.Y. 1991), *and* 126 B.R. 165 (Bankr. S.D.N.Y. 1991), *vacated by consent order*, 17 Employee Benefits Cas. (BNA) 1102 (S.D.N.Y. 1993).

Thus, PBGC has an extremely strong interest in whether bankruptcy courts are bound to adjudicate claims in accordance with the substantive nonbankruptcy law that gives rise to them. PBGC files this brief *amicus curiae* to urge the Court to conclude, in agreement with the Seventh and Fourth Circuits,[7] that notions of equity in bankruptcy may not be used to supplant substantive nonbankruptcy law. This proposition is true with respect to both state and federal laws, and is by no means unique to tax claims. Except where Congress so directs, bankruptcy courts do not have the authority to redefine entitlements under nonbankruptcy law.

SUMMARY OF THE ARGUMENT

Bankruptcy provides a forum in which all claims against a bankrupt entity may be asserted and dealt with in an expeditious manner. The grounds for these claims are as varied as the myriad commercial and legal relationships in which the bankrupt entity was involved prior to entering bankruptcy.

The Bankruptcy Code itself does not create claims. Thus, in dealing with claims against a debtor, a bankruptcy court must look to the substantive nonbankruptcy law to determine the validity and amount of each claim. The Court's precedents consistently indicate that a claimant's rights in bankruptcy are the same as they would be in the absence of bankruptcy, unless the Bankruptcy Code expressly alters those rights.

Section 502 of the Bankruptcy Code governs the determination of claims. Its language dictates that in the

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[7] *See In re Stoecker*, 179 F.3d 546 (7th Cir. 1999); *IRS v. Levy* (*In re Landbank Equity Corp.*), 973 F.2d 265, 270 (4th Cir. 1992).

event of a claims objection, the court is to determine the amount of the claim and allow it in that amount, except to the extent it is disallowable under any of the nine grounds listed in section 502(b).

Courts that have altered substantive rights in the interest of an uncodified policy of equality among creditors are mistaken. That equality relates to the distribution of the estate, and is embodied in other provisions of the Bankruptcy Code, such as the provisions that dictate that creditors in the same class receive pro rata shares of the estate. There is no need, nor any authority, for bankruptcy courts to substitute their notions of equality for those already embodied in the Bankruptcy Code.

The danger of permitting bankruptcy courts to alter the rights conferred by nonbankruptcy law on the basis of uncodified principles of equity is dramatically illustrated by several decisions involving PBGC's claims in bankruptcy. When a pension plan terminates, ERISA gives PBGC a claim against the plan sponsor for the plan's "unfunded benefit liabilities." ERISA also provides that the amount of unfunded benefit liabilities is to be calculated in accordance with assumptions prescribed in PBGC regulations. In several bankruptcy cases, however, courts have disregarded ERISA and the implementing regulation and recalculated PBGC's claim, purportedly in the interest of equality. In so doing, these courts have stripped tens of millions of dollars from the face amount of PBGC's claims.

This Court should affirm the Seventh Circuit and hold that bankruptcy courts are not free to alter the rights conferred by nonbankruptcy law, except as may be specifically provided in the language of the Bankruptcy Code.

ARGUMENT

1. When Congress defined a "claim" under the Bankruptcy Code broadly to include any "right to payment," 11 U.S.C. § 101(5), it assured that claims of virtually every possible origin could be brought before the bankruptcy court. Every claim against a debtor arises from a debtor-creditor relationship under *some* body of law—be it state or federal, statutory or common law. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 169 (1946) (Frankfurter, J., concurring) ("Obligations to be satisfied out of the bankrupt's estate thus arise, if at all, out of tort or contract or other relationship created under applicable law."); *see also id.* at 161 (majority opinion).

At the same time, this Court has stated that Congress's constitutional power to establish "uniform Laws on the subject of Bankruptcies," U.S. Const. art. 1, § 8, allows it to alter the property rights established by nonbankruptcy law. *Butner v. United States*, 440 U.S. 48, 54-55 (1979). In those instances in which Congress has decided that administration of the bankruptcy laws requires alteration of parties' substantive rights, it has made its intention clear in the bankruptcy laws, as with the provisions governing trustees' avoidance powers, 11 U.S.C. §§ 545-51, 553, and the provisions respecting priority of distribution of the estate to claimants, 11 U.S.C. §§ 507, 726.

Here, the state law undisputedly allocates the burden of proof to the taxpayer, and no provision of the Bankruptcy Code expressly *re*allocates that burden of proof to the taxing authority.[8] Under principles that the Court's

[8] As the court of appeals noted, *see Stoecker*, 179 F.3d at 552, the Bankruptcy Code contains several provisions that allocate burdens of proof in certain matters, *see* 11 U.S.C. §§ 362(g), 363(o), 364(d)(2), 547(g), 1129(d), but none that reallocate to the taxing

decisions consistently recognize, the taxing authority's entitlement in bankruptcy is presumptively determined by substantive nonbankruptcy law.

In *Grogan v. Garner*, 498 U.S. 279 (1991), the Court noted the distinction between the dischargeability of claims, which since 1970 had been a matter of federal law governed by the Bankruptcy Code and its predecessor, *see* 11 U.S.C. § 523, and the *validity* of claims, which "is determined by rules of state law." 498 U.S. at 283 (citing *Vanston*, 329 U.S. at 161). This observation is consistent with the Court's other precedents that touch on the question of applicable law.

In *Butner v. United States*, for example, the Court referred to applicable state law when the relevant bankruptcy statute, in that case, the Bankruptcy Act, was silent on the matter. There, the question was whether a security interest in real property extended to rents, a question on which state laws differ. 440 U.S. at 50. The Court noted that although Congress clearly has plenary power to establish uniform laws respecting bankruptcies, *id.* at 54, it had not exercised this power with respect to a mortgagee's rights in real property of the estate, which "are created and defined by state law." *Id.* at 55. Thus, "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 56.

Similarly, in a recent case involving the Bankruptcy Code's fraudulent conveyance provision, 11 U.S.C. § 548,

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authority the burden of proof on tax claims. Of these provisions, only section 1129(d) tangentially relates to taxes. That section prohibits a court from confirming a proposed plan of reorganization whose principal purpose is the avoidance of taxes or liability under the Securities Act of 1933

the Court held that whether a foreclosure sale provided "reasonably equivalent value" within the meaning of section 548 was governed by whether the sale was noncollusive and otherwise valid under the state law governing foreclosure sales. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 545 (1994). Since there was no "clear and manifest" indication of congressional intent to displace state foreclosure law, *id.* at 544, the legitimacy of the sale under state law controlled the question whether reasonably equivalent value had been received for the property. *Id.*

Though cases such as *BFP* and *Butner* deal with the circumstances under which state law should be applied in bankruptcy, *see BFP*, 511 U.S. at 544; *Butner*, 440 U.S. at 54-55, the Court has made the important observation that the relevant rule of law may come from federal law as well. "We use the term 'state law' expansively herein to refer to all nonbankruptcy law that creates substantive claims. We thus mean to include in this term claims that have their source in substantive federal law, such as federal securities law or other federal antifraud laws." *Grogan*, 498 U.S. at 284 n.9.[9] That is, in the context of bankruptcy, the issue is not so much whether, as a matter of federalism, to apply state law in the absence of overriding federal law, but whether, as a matter of choice-of-law, to apply nonbankruptcy law in the absence of overriding bankruptcy provisions. The latter view correctly recognizes that the Bankruptcy Code is essentially a procedural framework that provides a forum and procedures for expedient dispute resolution and distribution of the estate to creditors, but that "does not endeavor to supplant the substantive law," *Landbank Equity*, 973 F.2d

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[9] Indeed, as *Vanston* noted, the substantive rule of law may even stem from foreign law. 329 U.S. at 161 n.4.

at 270, except in ways clearly specified in the Bankruptcy Code.

2. Thus, the validity and amount of the claim of the Illinois Department of Revenue must be determined by reference to the law that gave rise to it, at least in the absence of some clear indication to the contrary in the Bankruptcy Code. And the language of the Bankruptcy Code—or more precisely, its eloquent silence, *Stoecker*, 179 F.3d at 552—makes clear that it has not displaced Illinois law in this respect. The remaining question, then, is whether, in the absence of an express reallocation of the burden of proof in tax cases, uncodified policies thought to be embodied in the Bankruptcy Code are a sufficient basis for overriding entitlements conferred by nonbankruptcy law. *See Franchise Tax Bd. v. MacFarlane (In re MacFarlane)*, 83 F.3d 1041, 1045 (9th Cir. 1996).

Petitioner's reliance on *Vanston* on this point, Brief for Petitioner at 23-24, is misplaced. Petitioner blurs *Vanston*'s recognition of the distinction between the allowability of a claim—i.e., the ability of a claim to share in the distribution of the estate—and the validity and the amount of the claim.[10] "What claims of creditors are valid and

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[10] The distinctions between the validity, provability, and allowability of bankruptcy claims under the Bankruptcy Act of 1898 were simplified by the enactment of the Bankruptcy Code, which abolished provability and codified the grounds for claim disallowance in section 502. As one court explained:

> Under the Bankruptcy Act of 1898, there are three distinct steps required to establish a claim. First, there must be a determination of the existence and amount of the liability based upon the prebankruptcy claim. Second, the claim must be "proved" in bankruptcy according to section 63 of the Act, 11 U.S.C. § 103 (1976) (repealed 1979). Third, if the claim is proved, the bankruptcy court must determine the claim's allowability under section 57 of the Act, 11 U.S.C. § 93 (1976) (repealed 1979).

Ohio v. Collins (In re Madeline Marie Nursing Homes), 694 F.2d 433, 437 (6th Cir. 1982); *see generally* Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U.L. Rev. 407, 426 (1972); Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013, 1017 (1955).

subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston*, 329 U.S. at 161. Once the amount of a claim is established, the allowability of the claim (and any distribution thereon) is determined by reference to the Bankruptcy Code. Recognizing this distinction, the Sixth Circuit has noted that equitable doctrines such as equitable subordination that are used to determine the allowability of claims "have never been applied . . . to oust state law in the original determination of the existence and amount of liability." *Unsecured Creditors' Comm. of Highland Superstores, Inc. v. Strobeck Real Estate (In re Highland Superstores, Inc.)*, 154 F.3d 573, 578-79 (6th Cir. 1998) (quoting *Madeline Marie*, 694 F.2d at 437); *accord Meindl v. Genesys Pac. Techs., Inc. (In re Genesys Data Techs., Inc.)*, No. 98-2270, 2000 WL 145105, at *3-4 (4th Cir. Feb. 9, 2000) (declining to create equitable exception to state law default judgment and 28 U.S.C. § 1738).[11]

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[11] Apart from the burden of proof area, the majority of cases to consider the question have concluded that nonbankruptcy law governs the validity and amount of a claim, and that any limits on allowance must be found in the Bankruptcy Code itself. *See Highland Superstores*, 154 F.3d at 578-79 (damages for lease rejection); *United States v. Sanford (In re Sanford)*, 979 F.2d 1511, 1513 (11th Cir. 1992) (penalties for failure to file tax returns); *Landsing Diversified Properties—II v. First Nat'l Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 595-97 (10th Cir. 1990) (attorney's fees under prepetition retainer agreement), *modi-*

Moreover, section 502 of the Bankruptcy Code has now largely subsumed *Vanston*'s discussion of the allowability of claims.[12] Under section 502, a claim (arising under whatever source of nonbankruptcy law) is presumptively deemed allowed. 11 U.S.C. § 502(a). In the event of an objection, section 502(b) dictates that after "determin[ing] the amount of [a] claim," the bankruptcy court "*shall allow* such claim in such amount," 11 U.S.C. § 502(b) (emphasis added), except to the extent it falls within one of nine (originally eight) enumerated exceptions. The language and structure of section 502 indicate that allowance is the rule, that disallowance is a matter of codified exceptions,[13] and that the determination of a

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fied on other grounds sub nom. Abel v. West, 932 F.2d 898 (10th Cir. 1991); *Murgillo v. California State Bd. of Equalization (In re Murgillo)*, 176 B.R. 524, 532 (B.A.P. 9th Cir. 1995) (sales tax); *cf. Madeline Marie*, 694 F.2d at 437-39 (6th Cir. 1982) (Medicaid overpayment) (Bankruptcy Act case); *United Merchants & Mfrs. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs.)*, 674 F.2d 134, 137 (2d Cir. 1982) (contractual collection costs) (Bankruptcy Act case); *but see PBGC v. CF&I Febricators*, 150 F.3d at 1300-01 (pension liabilities under ERISA).

12 *Vanston* is part of a continuum of cases on the narrow subject of allowance of claims for postpetition interest. *See Vanston*, 329 U.S. at 163, 165. This question is now subsumed by section 502(b)(2) of the Bankruptcy Code, providing for disallowance of unmatured interest, and section 506(b), permitting interest on the claim of an oversecured creditor. *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241-42 (1989); *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371-73 (1988); *Equitable Life Assurance Soc'y v. Sublett (In re Sublett)*, 895 F.2d 1381, 1386 (11th Cir. 1990).

13 Congress's addition of a ninth ground in 1994—for certain late-filed claims, *see* 11 U.S.C. § 502(b)(9)—further confirms that the section 502(b) exceptions are the exclusive grounds for disallowance. The legislative history of the Bankruptcy Code is in full accord. "Subsection (b) [of section 502] prescribes the grounds on which a claim may be disallowed. The court will apply these standards if there is an objection to a proof of claim." H.R. Rep. No. 95-595, at 352 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308; S. Rep. No. 95-989, at 62 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848.

claim's amount remains a matter of substantive nonbankruptcy law.

Although there are a handful of areas in which bankruptcy law may be said to override relevant nonbankruptcy law, e.g., avoidance of certain transfers under 11 U.S.C. §§ 544, 545, 547, and 548, these areas are specifically set forth in the language of the Bankruptcy Code. By contrast, a bankruptcy court's freewheeling use of equitable principles on matters otherwise governed by the language and structure of the Bankruptcy Code is not permitted. For example, while section 510 of the Bankruptcy Code provides a bankruptcy court some discretion to subordinate a claim "under principles of equitable subordination," 11 U.S.C. § 510(c), a court's categorical subordination of tax penalties, even for ostensibly equitable reasons, effectively rewrites the priority schemes of sections 507 and 726 and is therefore impermissible. *United States v. Noland*, 517 U.S. 535, 540-41 (1996). "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); *see Butner*, 440 U.S. at 56 (rejecting "undefined considerations of equity" as a basis for displacing applicable nonbankruptcy law).

Indeed, the courts that have replaced applicable nonbankruptcy law with their own notions of equity overlook that the relevant equitable principles are already embodied in the language and structure of Bankruptcy Code. For example, some courts have claimed that exercise of their equitable powers was necessary to assure equality among creditors. *See, e.g., MacFarlane*, 83 F.3d at 1045;

CF&I, 150 F.3d at 1301. However, as this Court has observed, such concerns are more aptly directed to *distribution* of the estate. "Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal priority should receive pro rata shares of the debtor's property." *Begier v. IRS*, 496 U.S. 53, 58 (1990); *see also* cases cited in Brief for Petitioner at 22 n.9, 26. This equality of distribution is already embodied in the provisions of the Code. *See, e.g.*, 11 U.S.C. § 1122 (requiring that Chapter 11 plans of reorganization classify claims or interests together only if they are "substantially similar"); *id.* § 1123(a)(4) (requiring that plans of reorganization "provide the same treatment for each claim or interest of a particular class").

The *MacFarlane* court's belief that it is unfair for the government to receive a "double benefit," 83 F.3d at 1045 (i.e., both a shift in the burden of proof on the question of the claim's validity, and eventual priority in distribution if the claim is ultimately allowed), is a nearsighted view of fairness. If the validity and amount of each claim are determined in accordance with the law that gave rise to it, and the assets of the estate are distributed in accordance with Congress's chosen distribution scheme, that is the very essence of fairness under the Bankruptcy Code. Each creditor receives the benefit of its bargain or statutory entitlement, which in each case was undertaken with some risk of eventual debtor insolvency. By contrast, it is unfair to strip one creditor of substantive rights simply because its claim is larger, its burden of proof is lower, or its entitlement is otherwise different from those of other creditors. As the Court noted in *Butner*, supplanting the relevant nonbankruptcy law on the basis of "undefined considerations of equity" is actually *in*equitable because it "affords the [debtor]

rights that are not his as a matter of state law." 440 U.S. at 56. The Court likewise condemned the "opposite inequity": by conferring new rights on a debtor, a bankruptcy court concomitantly deprives one or more creditors of some right or interest to which they are entitled under applicable law. *Id.*

3. There are important policy reasons that bankruptcy courts should be required to apply substantive nonbankruptcy law in determining the validity and amount of claims. Such a requirement assures consistency in adjudication, in that applications of nonbankruptcy law will not vary depending on whether the forum is a state court, an Article III court, or a federal bankruptcy court. "Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner*, 440 U.S. at 55 (citing *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961)).

Moreover, if substantive nonbankruptcy law is made less onerous (or suspended altogether) when applied in the context of bankruptcy, businesses and individuals have new incentives to declare bankruptcy, a factor the Seventh Circuit noted in this case.[14] If a taxpayer knew, for example, that it had a tax liability, but that the government would have difficulty proving the liability, bankruptcy could be an effective means of avoiding the liability.

Indeed, the abuse that is possible when relevant nonbankruptcy law is modified in determining the validity and

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[14] 179 F.3d at 552 ("The position for which the trustee contends has no more basis in the Code than in the law of Illinois, and it would create a new incentive to declare bankruptcy. We have enough bankruptcies.").

amount of a bankruptcy claim is dramatically illustrated by the treatment of PBGC's claims in bankruptcy. ERISA explicitly provides that a claim for "the total amount of unfunded benefit liabilities" of a terminated pension plan, 29 U.S.C. § 1362(b), is to be calculated using assumptions prescribed in PBGC regulations, 29 U.S.C. § 1301(a)(18).[15] PBGC has promulgated such a regulation, *see* 29 C.F.R. pt. 4044, and applied it in literally hundreds of pension plan terminations. Not a single court has held the regulation invalid.

Yet companies whose pension plans have had funding shortfalls in the hundreds of millions of dollars have successfully persuaded bankruptcy courts to disregard ERISA and PBGC's implementing regulation in favor of a debtor-oriented method of calculating the claim. For example, in *PBGC v. CF&I Fabricators*, the Tenth Circuit acknowledged that PBGC's regulation would have "the force of law" in other contexts, but held that it should not be followed in bankruptcy. 150 F.3d at 1301. "Even though that methodology was adopted in the exercise of PBGC's administrative authority, we have no doubt of its inapplicability in the world of bankruptcy." *Id.* In this way, bankrupt debtors have cut PBGC's termination liability claims to a fraction of their true amount, even before PBGC's recovery was further cut by the pro rata distribution to all unsecured creditors.

The results have been staggering. Alternative theories for calculating PBGC's claim have been substituted in

[15] "In a situation of this kind, Congress entrusts to the [agency], rather than to the courts, the primary responsibility for interpreting the statutory term." *Batterton v. Francis*, 432 U.S. 416, 425 (1977). *Accord Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984). Such express delegations give rise to legislative rules that have the "force and effect of law." *Chrysler Corp. v. Brown*, 441 U.S. 281, 295 (1979); *Batterton*, 432 U.S. at 425 n.9.

three cases litigated to a decision.[16] Against CF&I, PBGC's termination liability claim was sliced from $221 million to $123 million. In *LTV*, had the parties not reached settlement during the pendency of the appeal in that case, the bankruptcy court's ruling would have effectively reduced the agency's claim from $222 million to about $158 million. And in *CSC Industries*, the debtor's theory slashed the claim from $48 million to only $2 million. The pressures to seek bankruptcy protection are evident, when supposed equitable considerations can be used to eliminate or substantially reduce such multimillion dollar claims.

A bankruptcy court's refusal to determine the validity and amount of claims in accordance with substantive nonbankruptcy law can also lead to anomalous results in situations in which liability is joint and several. Under ERISA, liability of members of a controlled group[17] is joint and several. 29 U.S.C. § 1362(a). But if provisions of ERISA and applicable regulations may be disregarded in bankruptcy, the amount of a bankrupt controlled group member's liability may be substantially less than that of a nonbankrupt controlled group member.[18] Thus, the perverse incentives that would obtain in a system that does not apply the nonbankruptcy law to determine the validity and amount of claims are by no means limited to the burden of proof in taxation cases.

[16] *See* cases cited *supra* at 4 & n.6.

[17] A "controlled group" is a group of trades or businesses under common control, e.g., a parent corporation and its 80-percent owned subsidiaries. *See* 29 U.S.C. § 1301(a)(14); I.R.C. § 414(b), (c); 29 C.F.R. § 4001.3; Treas. Reg. 1.414(b)-1, (c)-2.

[18] Similarly, in a tax case such as this one, the shift of the burden of proof in bankruptcy could result in exoneration from tax liability of one jointly liable party, but not its nonbankrupt co-liable affiliate, simply because the former enjoyed a reallocated burden of proof.

Bankruptcy decisions that disregard nonbankruptcy law may also lead to distortions in regulatory and enforcement programs as agencies search for ways to neutralize bankruptcy judges' equitable impulses. For example, decisions like *CF&I* would make it advantageous for PBGC to terminate pension plans *before* companies declare bankruptcy, even though ERISA encourages the continuation of pension plans. *See* 29 U.S.C. § 1302(a)(1). Of course, upon termination of a pension plan, active employees cease accruing service credit, and all participants lose benefits exceeding PBGC's guarantee.

The conclusion that uncodified bankruptcy policies override other statutory schemes is a particularly dangerous rule for governmental entities, which depend on uniform compliance with their regulatory programs. As this Court said nearly a century ago, if Congress intended a bankruptcy exception to the general law, "the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt." *Swarts v. Hammer*, 194 U.S. 441, 444 (1904), *quoted with approval in Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 502 (1986).

PBGC urges the Court to provide needed guidance to the lower courts with respect to all bankruptcy claims, not just tax claims. Otherwise, lower courts may confine the Court's decision to claims involving taxes, or burdens of proof, while continuing to wield their equitable swords when adjudicating claims that originate in other areas of nonbankruptcy law. The Court can avoid that result by confirming that, in determining the validity and amount of a claim in bankruptcy, a court must apply the nonbankruptcy law that gave rise to the claim, and must then, as the language of the Bankruptcy Code instructs,

allow the claim in the amount so determined, except to the extent one of section 502(b)'s nine exceptions limits allowance.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the court of appeals.

Respectfully submitted,

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